



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 203

**[Docket No. FR-5397-N-04]
RIN 2502-ZA05**

**Federal Housing Administration (FHA): Temporary Exemption
from Compliance with FHA's Regulation on Property Flipping
Extension of Exemption**

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Notice of waiver extension.

SUMMARY: This notice announces that FHA is extending the availability of the temporary waiver of its regulation that prohibits the use of FHA financing to purchase single family properties that are being resold within 90 days of the previous acquisition, until December 31, 2012. This waiver, which was first issued in January 2010, took effect for all sales contracts executed on or after February 1, 2010, and was extended in February 2011. The waiver is set to expire on December 31, 2011, and therefore HUD is extending the waiver for another calendar year. Prior to the waiver, a mortgage was not eligible for FHA insurance if the contract of sale for the purchase of the property that is the subject of the mortgage is executed within 90 days of the prior acquisition by the seller and the seller does not come under any of the exemptions to this 90-day period that are specified in the regulation. As a result of the high foreclosures that have been taking place across the nation, FHA, through the regulatory waiver, encourages investors that specialize in acquiring and renovating properties to renovate foreclosed and abandoned homes with the objective of increasing the availability of affordable homes for first-

time and other purchasers and helping to stabilize real estate prices as well as neighborhoods and communities where foreclosure activity has been high. While the waiver is available for the purpose of stimulating rehabilitation of foreclosed and abandoned homes, the waiver is applicable to all single family properties being resold within the 90-day period after prior acquisition, and was not limited to foreclosed properties. Additionally, the waiver is subject to certain conditions, and eligible mortgages must meet these conditions to take advantage of the waiver. The waiver is not applicable to mortgages insured under HUD's Home Equity Conversion Mortgage (HECM) Program.

DATES: Effective Date: **January 1, 2012, through December 31, 2012.**

FOR FURTHER INFORMATION CONTACT: Karin B. Hill, Director, Office of Single Family Program Development, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Washington, DC 20410-8000; telephone number 202-708-2121 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION:

I. Background

Section 203.37a(b)(2) of HUD's regulations (24 CFR 203.37a(b)(2)) establishes FHA's rule on property flipping and this regulatory section provides that FHA will not insure a mortgage for a single family property if the contract of sale is executed within 90 days of the acquisition of the property by the seller. Section 203.37a(c) lists the sales transactions that are exempt from this rule. The exempt transactions include, for example, sales by HUD of real estate-owned (REO) properties under HUD's regulations in 24 CFR part 291, sales by another

federal agency of REO properties, sales of properties by nonprofit organizations that have been approved to purchase and resell HUD REO properties, and sales by state- and federally-chartered financial institutions and government sponsored enterprises, to name a few.

Property “flipping” refers to the practice whereby a property recently acquired is resold for a considerable profit with an artificially inflated value, often the result of a lender’s collusion with the appraiser. Most property flipping occurs within a matter of days after acquisition, and usually with only minor cosmetic improvements, if any. In an effort to preclude this predatory lending practice with respect to mortgages insured by FHA, HUD issued a final rule on May 1, 2003 (68 FR 23370) that provides in 24 CFR 203.37a that FHA will not insure a mortgage if the contract of sale for the purchase of the property that is the subject of the mortgage is executed within 90 days of the prior acquisition by the seller and the seller does not come under any of the exemptions to this 90-day period that are specified in § 203.37a(c).

In a final rule published on June 7, 2006 (71 FR 33138), HUD expanded the exceptions contained in § 203.37a(c) to the 90-day time restrictions to include such transactions as sales of single family properties by government-sponsored enterprises (GSEs), state- and federally-chartered financial institutions, nonprofits organizations approved to purchase HUD Real Estate-Owned (REO) single family properties at a discount with resale restrictions, local and state governments and their instrumentalities, and, upon announcement by HUD through issuance of a notice, sales of properties in areas designated by the President as federal disaster areas.

The downturn in the housing market over the past few years has led to a rapid rise of homeowners defaulting on mortgages, and consequently an increase in foreclosed homes. A variety of measures to avoid foreclosures have been initiated at the federal, state and local level, most notably the Administration’s Home Affordable Modification Program. Despite these

efforts to keep families in their homes, foreclosures continue to remain high and not only do foreclosures affect the families that lost their homes, but they affect neighborhoods and communities. While HUD continues its efforts to help homeowners remain in their homes, through waiver of its regulation on property flipping, HUD seeks to help stabilize neighborhoods and communities.

HUD undertook similar waiver action in a narrower context in 2009, regarding HUD's Neighborhood Stabilization Program (NSP). NSP, a temporary program authorized by the Housing and Economic Recovery Act 2008 (Public Law 110-289, approved July 30, 2008), was established for the purpose of stabilizing communities that have suffered from foreclosures and abandonment, by allocating funds through a formula to States and units of general local government, for the purchase and redevelopment of foreclosed and abandoned homes and residential properties. HUD's waiver of its regulation on property flipping for NSP removed an impediment to the purchase of affordable homes that had been rehabilitated and sold under this program.

With the home foreclosure rate remaining high across the nation, HUD determined, early in 2010, that a temporary waiver of this regulation on a nationwide basis, subject to certain conditions, may contribute to stabilizing real estate prices and neighborhoods that have been heavily impacted by foreclosures, and may facilitate the sale and occupancy of foreclosed homes that have been rehabilitated by making the mortgages of such homes eligible for FHA mortgage insurance. The original waiver granted in 2010 was discussed in a HUD Federal Register notice published on May 21, 2010 (75 FR 28633), which solicited public comment. HUD addressed the public comments in the extension of the original waiver published on February 3, 2011 (76 FR 6149). Given that the housing market, although improving, remains in a vulnerable states, and

the foreclosure rate, while lower than previously, nevertheless remains high, HUD is extending the waiver for another calendar year. The conditions for the waiver set forth in both the May 10, 2010, and February 3, 2011, Federal Register notices remain applicable and are set out in this notice for the convenience of the reader.

While the waiver remains available for the purpose of stimulating rehabilitation of foreclosed and abandoned homes for another calendar year, the waiver continues to remain applicable to all properties being resold within the 90-day period after prior acquisition. The waiver is not limited to the resale of foreclosed properties.

II. Eligibility for Waiver of 24 CFR 203.37a(b)(2)

To be eligible for the waiver of the Property Flipping Rule, an FHA-approved mortgagee must meet the following conditions:

1. All transactions must be arms-length, with no identity of interest between the buyer and seller or other parties participating in the sales transaction. Some ways that the lender can ensure that there is no inappropriate collusion or agreement between parties, are to assess and determine the following:

- a. The seller holds title to the property;
- b. Limited liability companies, corporations, or trusts that are serving as sellers were established and are operated in accordance with applicable state and federal law;
- c. No pattern of previous flipping activity exists for the subject property as evidenced by multiple title transfers within a 12 month time frame (chain of title information for the subject property can be found in the appraisal report);
- d. The property was marketed openly and fairly, through a multiple listing service (MLS), auction, for sale by owner offering, or developer marketing (any sales contracts that refer to an

“assignment of contract of sale,” which represents a special arrangement between seller and buyer may be a red flag).

2. In cases in which the sales of the property is greater than 20 percent above the seller’s acquisition cost, an FHA-approved mortgagee is eligible for the waiver only if the mortgagee:

a. Justifies the increase in value by retaining in the loan file supporting documentation and/or a second appraisal, which verifies that the seller has completed sufficient legitimate renovation, repair, and rehabilitation work on the subject property to substantiate the increase in value or, in cases where no such work is performed, the appraiser provides appropriate explanation of the increase in property value since the prior title transfer; and

b. Orders a property inspection and provides the inspection report to the purchaser before closing. The mortgagee may charge the borrower for this inspection. The use of FHA-approved inspectors or 203(k) consultants is not required. The inspector must have no interest in the property or relationship with the seller, and must not receive compensation for the inspection for any party other than the mortgagee. Additionally, the inspector may not: compensate anyone for the referral of the inspection; receive any compensation for referring or recommending contractors to perform any repairs recommended by the inspection; or be involved with performing any repairs recommended by the inspection. At a minimum, the inspection must include:

- i. The property structure, including the foundation, floor, ceiling, walls and roof;
- ii. The exterior, including siding, doors, windows, appurtenant structures such as decks and balconies, walkways and driveways;
- iii. The roofing, plumbing systems, electrical systems, heating and air conditioning systems;

- iv. All interiors; and
- v. All insulation and ventilation systems, as well as fireplaces and solid fuel-burning appliances.

3. Only forward mortgages are eligible for the waiver. Mortgages insured under HUD's HECM program are ineligible for the waiver.

III. Guidance on the Conditions for Waiver Eligibility

A. Seller's Acquisition Cost

The seller's acquisition cost is the purchase price which the seller paid for the property, and the following costs (if paid by the seller):

- Closing costs, plus
- Prepaid costs, including commissions.

The seller's acquisition cost does not include the cost of repairs that the seller makes to the property.

B. Justification and Documentation of Increase in Value

If the resale price of the property is greater than 20 percent above the seller's acquisition cost, the property will be eligible for an FHA-insured mortgage only if the Mortgagee justifies the increase in value. The Mortgagee must verify that the seller has completed sufficient legitimate renovation, repair, or rehabilitation work on the subject property to substantiate the increase in value by retaining supporting documentation in the loan file or by providing a second appraisal.

- If the Mortgagee uses a second appraisal:
 - An FHA roster appraiser must perform the appraisal in compliance with all FHA appraisal reporting requirements.

- The Mortgagee may not use an appraisal done for a conventional loan even if it was completed by an FHA roster appraiser.
- The Mortgagee may not charge the cost of the second appraisal to the homebuyer.

If the Mortgagee has ordered a second appraisal to document the increase in value, the Mortgagee must not use this appraisal for case processing and must not enter it into FHA Connection.

C. Property Inspection Report

If the resale price of the property is greater than 20 percent above the seller's acquisition cost, the property will be eligible for an FHA-insured mortgage only if the Mortgagee obtains a property inspection and provides the inspection report to the buyer before closing. The borrower, lender, or mortgage broker (if one is involved in the transaction) may order the property inspection. The lender or mortgage broker may charge the borrower for this inspection.

D. Repairs

If the inspection report notes that repairs are required because of structural or "health and safety" issues, those repairs must be completed prior to closing. After completion of repairs to address structural or "health and safety" issues, the inspector must conduct a final inspection to determine if the repairs have been completed satisfactorily and eliminated the structural or "health and safety" issues. The borrower, lender, or mortgage broker may order the final inspection.

IV. Compliance with the Paperwork Reduction Act

The information collection requirements applicable to this waiver have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44

U.S.C. 3501-3520) and assigned OMB Control No. 2502-0059. In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless the collection displays a currently valid OMB control number.

V. Period of Waiver Eligibility

The waiver that is the subject of this notice remains effective through December 31, 2012, for all sales contracts executed on or after February 1, 2010, the availability date provided by the issuance of the waiver in January 2010, unless extended or withdrawn by HUD.

By notice, HUD shall notify the public of any extension or withdrawal of this waiver. If as a result of this waiver, there is a significant increase in defaults on FHA-insured mortgages and an increase in mortgage insurance claims that are attributable to mortgages insured as a result of exercise of this waiver authority, HUD may withdraw this waiver immediately.

Dated: December 22, 2011

Carol J. Galante
Acting Assistant Secretary for Housing—
Federal Housing Commissioner

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